

University of Groningen

Studies in Local Marketing

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Document Version

Publisher's PDF, also known as Version of record

Publication date:

2004

[Link to publication in University of Groningen/UMCG research database](#)

Citation for published version (APA):

van Dijk, A. (2004). *Studies in Local Marketing*. [Thesis fully internal (DIV), University of Groningen]. s.n.

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Chapter 1

Introduction

In 1835 the *Beagle* arrived in the Galapagos archipelago. One of its crew members, Charles Darwin, discovered that different species of finches lived on the different islands. These finches had different types of beaks customized to the diet on each island (seeds, insects). Nature had formed these species by selecting those finches that were better able to survive (natural selection). This discovery led to Darwin's theory of evolution.

When we travel around the country we discover that there are many differences between stores belonging to the same chain, situated in different neighborhoods. If we take a closer look we see that some of these stores customize their marketing mix to the specific needs and wants of a neighborhood. For example, stores in a neighborhood with many babies may (i) allocate more shelf space to products such as diapers and baby food, (ii) select products based on the consumer profile, and (iii) adapt the promotional program to the local competition. This strategy is used to perform better (survive) and is called local marketing – the subject of this thesis.

However, local marketing is not the only possible strategy to compete. Treacy and Wiersma (1993) state that the key issue for most firms is how to deliver superior customer value. This can be done by choosing one of the following value disciplines or strategies: *customer intimacy* (tailoring products to the individual customer), *operational excellence* (excelling in operational aspects) or *product leadership* (offering continuously improved products and/or services). Local marketing fits a customer intimacy discipline best (see also Chapter 2).

In this thesis we study local marketing. Local marketing has recently received increased attention from both practice and marketing science. This study aims to enhance the knowledge about local marketing. Specifically, the objectives of this thesis are to study (i) the definition of local marketing and its origin, (ii) the implementation of local marketing in Dutch practice, (iii) existing models for local marketing, their shortcomings and the available data, and (iv) models that overcome selected shortcomings.

Chapter 1

In Chapter 2 we focus on the first objective: the definition and history of local marketing. We make the implicit definition used in this introduction more specific (local marketing as the customization of a store to the neighborhood). We compare alternative terms and definitions. The second part of Chapter 2 considers the origin of local marketing. We describe relevant developments in marketing and discuss their implications. This chapter also explains why local marketing is relevant nowadays.

In Chapter 3 we consider local marketing in Dutch practice (second objective). We address the following questions: (i) why is local marketing applied, (ii) how is local marketing applied, and (iii) how much does local marketing depend on the marketing instruments. We study these questions in both a qualitative (in-depth interviews) and a quantitative way (written survey).

In Chapter 4 we study existing models, their shortcomings and store profile data (third objective). First, we illustrate what is done in practice by describing the products offered by ACNielsen. Second, we discuss the models developed in the marketing science literature that relate store profile variables to marketing mix effects. The last part of this chapter considers the data on store profiles available in the Netherlands. We focus on data on consumer characteristics.

In Chapter 5 we consider the problem that there is often insufficient data to estimate marketing instrument effects for a single store based on weekly data. There are usually too few weeks to estimate complex models for a single store. We calibrate a model on daily data which results in six times as many observations (the store is usually closed on Sundays) which enables us to estimate more complex models. We develop a model to decompose price effects in terms of sales within and across categories. We extend recently developed sales decomposition models. By modeling a single store we accommodate store heterogeneity by estimating store-specific effects.

In Chapter 6 we consider the problems associated with the use of cross-sectional data (across stores). Current models for local marketing use these data to estimate sales potential and instrument effects. In general, if instruments do not vary over time it is tempting to use cross sectional data to determine their effects. The problem with data across stores is that unobserved retailer behavior affects the use of the marketing instruments. That is, unobserved factors influence the levels of the instruments. This implies that the relation between sales and an instrument is only partially due to the effect of the instrument on sales, and that

OLS estimates are biased as a result. Specifically, the assumption in *OLS* of no correlation between the error term and the predictor variables is violated.

We use similarity-based spatial methods to estimate shelf-space elasticity. Shelf-space allocation is an instrument that shows little or no variation over time. We develop a model that accommodates unobserved retailer behavior through a spatial structure based on store profiles. This spatial structure defines which stores are neighbors in a store profile space. The model relates the error term for a store to its contiguous neighbors. This method builds on the work of Bronnenberg and Mahajan (2001) who use geographical coordinates. We argue that in our application it is more appropriate to use store profiles instead.

In Chapter 7, we provide a summary of the results of this thesis. We discuss the most important findings and give recommendations for future research.

